

Message Text

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INFO AMEMBASSY HELSINKI

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PASS CEA, TREASURY, FRB

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TAGS: ECON, OECD
SUBJECT: ECONOMIC AND DEVELOPMENT REVIEW COMMITTEE (EDRC)
REVIEW OF FINLAND

REF: EDR(76)30

1. SUMMARY: AT DECEMBER 13 EDRC REVIEW FINNISH DEL
(LED BY LINDBLUM, MINISTRY OF FINANCE) STRESSED THAT
FINNISH POLICY OF DOMESTIC DEMAND RESTRAINT WAS CONSIS-
TENT WITH PRESCRIPTION OUTLINED FOR WEAK COUNTRIES AT
NOVEMBER EPC, AND THAT SUCCESS OF THAT STRATEGY WOULD
DEPEND ON STRONG COUNTRIES' MAINTAINING GROWTH RATES
CONSISTENT WITH "SCENARIO" ENDORSED AT JUNE OECD
MINISTERIAL. IN FULFILLING STRATEGY, FINNS INDICATED
THEY WILL RELY PRIMARILY ON DEMAND MANAGEMENT POLICY,
WITH INCOMES POLICY RELEGATED TO SECONDARY ROLE. THEY
FELT THAT SECRETARIAT FORECASTS FOR 1977 WERE ON LOW
SIDE, BUT MORE IMPORTANTLY, THEY SAID THAT OVERALL TONE
OF DRAFT SURVEY GAVE UNWARRANTED IMPRESSION OF PESSIMISM
CONCERNING OUTLOOK FOR FINNISH ECONOMY IN 1977. SECRE-
TARIAT AGREED TO WORK ON "TONE," BUT DOES NOT PLAN TO
CHANGE ITS FORECASTS. FINNS DO NOT EXPECT DIFFICULTY
IN FINANCING 1977 CURRENT ACCOUNT DEFICIT, NOR DO THEY
FEEL THAT BURDEN OF EXTERNAL DEBT HAS REACHED ALARMING
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PROPORTIONS. NEVERTHELESS, A CENTRAL OBJECTIVE OF

FINNISH ECONOMIC POLICY REMAINS TO REDUCE CURRENT ACCOUNT DEFICIT TO TWO PERCENT OF GDP BY 1980, AND ARE PREPARED TO CONTINUE RESTRAINT OF DOMESTIC DEMAND TO SECURE THAT OBJECTIVE. END SUMMARY.

2. SHORT-TERM PROSPECTS; DOMESTIC OUTLOOK: FINNS POINTED TO RECENT FIGURES INDICATING THAT GDP COULD GROW BY 0.25 PERCENT IN 1976 AS OPPOSED TO PREVIOUSLY FORECAST GROWTH RATE OF MINUS 0.5 PERCENT. THEY ARGUED THAT STRONGER-THAN-EXPECTED GDP GROWTH DURING 1976 WOULD ALSO HAVE EFFECT OF RAISING "STARTING-POINT" FOR 1977, AND THAT 4 PERCENT AVERAGE GROWTH RATE FOR 1977 FORECAST BY SECRETARIAT COULD BE ATTAINED EVEN IF GDP GREW MINIMALLY DURING COURSE OF NEXT YEAR. FINNS CONCLUDED THAT SECRETARIAT GROWTH FORECAST COULD WELL BE ON LOW SIDE, ALTHOUGH THEY DID NOT PRESENT SPECIFIC OFFICIAL FORECAST.

3. MOREOVER, FINNISH DEL STRESSED THAT OVERALL TONE OF DRAFT SURVEY WAS OVERLY PESSIMISTIC CONCERNING OUTLOOK FOR 1977. SPECIFICALLY, FINNS POINTED TO DEPRESSING INTRODUCTION TO SURVEY, WHEREIN SECRETARIAT INDICATES THAT "EXTERNAL BALANCE REMAINS WORRYING, INFLATION (THOUGH DECELERATING) CONTINUES AT HIGH RATE, AND EMPLOYMENT HAS BEGUN TO INCREASE." THEY SAID THAT HIGH INFLATION, WORRISOME CURRENT ACCOUNT OR INCREASE IN UNEMPLOYMENT COULD OCCUR IN 1977, BUT THAT ALL THREE PESSIMISTIC OUTCOMES WERE NOT LIKELY TO BE REALIZED SIMULTANEOUSLY. SECRETARIAT ACKNOWLEDGED THAT FINNISH GDP HAD GROWN MORE STRONGLY THAN EXPECTED IN 1976, BUT POINTED OUT THAT FINAL DOMESTIC DEMAND WAS EVEN WEAKER THAN FORESEEN IN EARLIER FORECASTS, A DEVELOPMENT WHICH WAS OFFSET BY FACT THAT INVENTORY DECUMULATION HAD PROCEEDED MORE SLOWLY THAN PREDICTED. SECRETARIAT CONCLUDED THAT EXCESS STOCKS HAD NOT BEEN SHAKEN OUT DURING 1976 AND THAT ITS FORECASTS OF CONTRIBUTION OF STOCK MOVEMENTS TO 1977 GDP GROWTH WOULD BE REVISED DOWNWARD, THEREBY WASHING OUT THE MECHANICAL EFFECT OF HIGHER STARTING POINT FOR 1977 AND LEAVING GROWTH FORECASTS UNAFFECTED. ON A BROADER QUESTION OF OVERALL LIMITED OFFICIAL USE

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TONE OF SURVEY, SECRETARIAT NOTED THAT HIGH UNEMPLOYMENT (SECRETARIAT FORECASTS UNEMPLOYMENT OF NEARLY 5 PERCENT NEXT YEAR IN CONTRAST WITH GOF PROJECTION OF 3.5 PERCENT) AND DETERIORATING CURRENT ACCOUNT COULD WELL COEXIST (E.G. BECAUSE OF WEAK EXPORT GROWTH), BUT AGREED TO MASSAGE INTRODUCTION TO ASSUAGE FINNS.

4. WAGES AND PRICES: FINNS AGREED WITH SECRETARIAT

PROJECTION THAT INFLATION RATE WOULD DECELERATE DURING
1977 AND WOULD REGISTER YEARLY AVERAGE INCREASE OF 10

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PERCENT OVER 1976. GOF FORECAST BASED ON ASSUMPTION
THAT CENTRALIZED WAGE AGREEMENTS (JANUARY 1977) WILL
RESULT IN NOMINAL WAGE INCREASE OF 4 PERCENT, THAT
WAGE DRIFT WILL ADD ANOTHER 3.5 PERCENT AND THAT
INCREASE IN HOURS WORKED WILL TACK ON 1 PERCENT, SO THAT
AVERAGE EARNINGS COULD INCREASE BY ABOUT 8.5 PERCENT.
FINNS STRESSED THAT THEY WILL RELY ON RESTRICTIVE
DEMAND MANAGEMENT POLICIES RATHER THAN INCOMES POLICY TO
HELP BRING ABOUT MODERATE EVOLUTION OF NOMINAL INCOMES.
IN SUPPORTING PRIMACY OF DEMAND MANAGEMENT POLICIES
OVER INCOMES POLICIES THEY RECALLED THAT IN 1974-75
CENTRALIZED AGREEMENTS AWARDED WAGE INCREASES OF 13
PERCENT, BUT THAT STRONG WAGE-DRIFT (7-8 PERCENT),
RESULTING FROM TIGHT LABOR MARKETS, HAD PUSHED WAGE
BILL ADDITIONALLY UPWARD. FINNS DREW CONCLUSION THAT
INCOMES POLICIES COULD NOT BE SUCCESSFUL IN RESTRAINING
WAGE INCREASES IN ABSENCE OF PRUDENT MONETARY AND FISCAL
POLICIES -- EVEN IF GOVERNMENTS SWEETEN POT (AS GOF
DID IN 1974/75) WITH TAX CONCESSIONS. ACCORDING TO
FINNISH REP, GOF DOES NOT INTEND TO USE TAX CUT PLANNED
FOR 1977 AS TAX/WAGE BARGAINING LEVER IN JANUARY WAGE

NEGOTIATIONS AND, IN GENERAL, PLANS TO MAINTAIN LOWER PROFILE DURING THESE NEGOTIATIONS THAN IT HAS IN RECENT PAST. (FINNS ALSO OBJECTED TO SECRETARIAT'S DESCRIPTION OF TAX CUT AS "VIRTUAL INDEXATION" OF TAXES, AND SAID LIMITED OFFICIAL USE

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THAT SUCH A TAX ADJUSTMENT DID NOT HAVE PASSIVE, AUTOMATIC IMPLICATIONS OF TAX INDEXATION.)

5. CURRENT ACCOUNT: FINNS FORECAST \$770 MILLION CURRENT ACCOUNT DEFICIT FOR 1977 COMPARED WITH SECRETARIAT FORECAST OF \$1.1 BILLION. BOTH GOF AND SECRETARIAT FORECAST 10 PERCENT INCREASE IN EXPORT VOLUMES, BUT FINNS NOTED THAT WEAK STOCK OUTLOOK ARGUED FOR SLOW GROWTH OF IMPORT VOLUMES. FINNS DO NOT EXPECT FINANCING OF DEFICIT TO BE DIFFICULT, WERE NOT ALARMED BY FACT THAT EXTERNAL DEBT STANDS AT 21 PERCENT OF GDP, AND NOTED THAT RATIO OF DEBT SERVICE PAYMENTS TO EXPORT RECEIPTS HAS BEEN STABLE SINCE 1968. THEY ADDED, HOWEVER, THAT THIS RELATIVELY OPTIMISTIC ASSESSMENT OF THEIR EXTERNAL SITUATION WAS BASED ON ASSUMPTION THAT PAUSE IN GROWTH RATES OF STRONGER OECD COUNTRIES WOULD NOT CONTINUE.

6. FINNS REITERATED THEIR MEDIUM-TERM GOAL OF REDUCING CURRENT ACCOUNT DEFICIT TO 2 PERCENT OF GDP BY 1980. THEY FELT THAT PATTERN CONSISTENT WITH THEIR OBJECTIVE WOULD BE 3.5-4 PERCENT GROWTH OF DOMESTIC DEMAND THROUGH 1980, WITH POSITIVE CONTRIBUTION OF REAL FOREIGN BALANCE RAISING AVERAGE ANNUAL GDP GROWTH TO ABOUT 5 PERCENT. THEY STRESSED THAT SLOW GROWTH OF DOMESTIC DEMAND (AND OF IMPORTS) WOULD REQUIRE CONTINUED DEMAND MANAGEMENT POLICY RESTRAINT, WHILE EXPORT VOLUME FORECAST (7 PERCENT INCREASE PER ANNUM) ASSUMED REAL GROWTH OF OECD-AREA GNP IN LINE WITH MEDIUM-TERM "SCENARIO" (5 PERCENT PLUS) ENDORSED AT JUNE MINISTERIAL.

7. FISCAL AND MONETARY POLICY: FINNS QUIBBLED WITH SECRETARIAT ECONOMETRIC ANALYSIS WHICH INDICATED THAT FISCAL DRAG HAD DEPRESSED GDP GROWTH IN PAST AND THAT DISCRETIONARY FISCAL POLICY SHIFTS HAD OFTEN HAD PRO-CYCLICAL IMPACT. HOWEVER, FINNS AND SECRETARIAT AGREED ON FUNDAMENTAL POINTS THAT FISCAL POLICY SHOULD REMAIN

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PRUDENT IN 1977 AND THAT MEASURES SHOULD BE TAKEN TO INCREASE FLEXIBILITY OF FISCAL POLICY AS COUNTER-CYCLICAL TOOL. FINNS NOTED THAT LAWS AIMED AT INCREASING FISCAL POLICY FLEXIBILITY (EXPORT LEVY LAW, INVESTMENT TAX BILL AND COUNTER-CYCLICAL DEPOSIT BILL) WERE NOW BEFORE PARLIAMENT, BUT THEIR DESCRIPTION OF TORTUOUS LEGISLATIVE PROCESS GAVE IMPRESSION THAT NEW WEAPONS WILL NOT BE ADDED TO GOF POLICY ARSENAL IN NEAR FUTURE.

8. FINNS EMPHASIZED THAT MONETARY POLICY WILL REMAIN TIGHT NEXT YEAR, AND STATED THAT CONTROLS ON CAPITAL INFLOWS WILL CONTINUE. ACCORDING TO FINNS, MAIN PROBLEM FOR MONETARY POLICY WILL BE TO ABSORB LIQUIDITY RELEASED WHEN IMPORT DEPOSIT SCHEME IS TERMINATED AT END OF 1976. (THEY INDICATED THAT PHASE-OUT OF SCHEME HAS PROCEEDED ON SCHEDULE THIS YEAR.) GOF PLANS TO NEUTRALIZE INCREASE IN LIQUIDITY BY REDUCING QUOTAS FOR CREDIT EXPANSION.

9. MAIN EDRC CONCLUSION WAS THAT GOF SHOULD CONTINUE TO RESTRAIN GROWTH OF DOMESTIC DEMAND IN HOPE THAT REVIVAL OF GROWTH OF WORLD TRADE WILL DRAG FINNISH ECONOMY OUT OF THE MUD.

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